

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0458RST
Sales and Use Tax
For Years 1994 through 1996

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ISSUES

I. Use Tax – Calculation of use tax liability.

Authority: Ind. Code § 6-2.5-3-2.

The taxpayer protests the method employed by the auditor in calculating the use tax liability.

II. Use Tax - Liability for use tax on purchases of pest control and fumigation supplies.

Authority: Ind. Code § 6-2.5-5-3;
 Ind. Code § 6-2.5-5-5.1;
 Ind. Admin. Code tit. 45, r. 2.2-5-8;
Indiana Department of State Revenue v. RCA Corporation, 310 N.E.2d 96 (Ind. App. 1974);

The taxpayer protests the assessment of use tax on its purchases of pest control and fumigation supplies.

III. Use Tax – Liability for use tax on purchases of forklift repair parts and fuel.

Authority: Ind. Code § 6-8.1-5-1.

The taxpayer protests the assessment of use tax on its purchases of forklift repair parts and fuel.

IV. Use Tax – Liability for use tax on purchases of safety gloves, aprons, and boots.

Authority: Ind. Admin. Code tit. 45, r. 2.2-5-8.

The taxpayer protests the assessment of use tax on its purchases of gloves, aprons, and boots.

V. Use Tax – Liability for use tax on purchases of terry cloth gloves.

Authority: Ind. Code § 6-2.5-5-3.

The taxpayer protests the assessment of use tax on its purchases of terry cloth gloves.

VI. Use Tax – Liability for use tax on purchases of boiler compound and water softener salt.

Authority: Ind. Code § 6-2.5-5-5.1;
Ind. Admin. Code tit. 45, r. 2.2-5-10;
Ind. Admin. Code tit. 45, r. 2.2-5-12.

The taxpayer protests the assessment of use tax on its purchases of boiler compound and water softener salt.

VII. Use Tax – Liability for use tax on purchases of UPC and product labels.

Authority: Ind. Code § 6-2.5-5-6.

The taxpayer protests the assessment of use tax on its purchases of UPC and product labels.

VIII. Use Tax – Liability for use tax on purchases of fan motors and fan repair parts.

Authority: Ind. Code § 6-2.5-5-3;
Ind. Admin. Code tit. 45, r. 2.2-5-8.

The taxpayer protests the assessment of use tax on its purchases of fan motors and fan repair parts.

IX. Use Tax – Liability for use tax on purchases of mothballs.

Authority: Ind. Admin. Code tit. 45, r. 2.2-5-16.

The taxpayer protests the assessment of use tax on its purchases of mothballs.

X. Use Tax – Liability for use tax on purchases of miscellaneous production supplies and equipment.

Authority: Ind. Code § 6-2.5-5-3;
Ind. Admin. Code tit. 45, r. 2.2-5-8;
Ind. Admin. Code tit. 45, r. 2.2-5-10.

The taxpayer protests the assessment of use tax on its purchases of miscellaneous production supplies and equipment.

XI. Use Tax – Calculation of exempt portion of taxpayer's purchase of warehouse carts.

Authority: Ind. Code § 6-8.1-5-1.

The taxpayer protests the calculation of the exempt portion of its purchase of warehouse carts.

XII. Use Tax – Liability for use tax on its purchases of materials used in construction of bleach facility buildings.

Authority: Ind. Admin. Code tit. 45, r. 2.2-4-21;
Indiana Department of Revenue Sales Tax Bulletin #9 (Apr. 1992).

The taxpayer protests the assessment of use tax on its purchases of materials used in construction of bleach facility buildings.

XIII. Use Tax – Liability for use tax on purchases of photographs and photographic services.

Authority: Ind. Code § 6-2.5-3-2;
Ind. Admin. Code tit. 45, r. 2.2-4-2;
Indiana Department of Revenue Sales Tax Bulletin #34 (Apr. 4, 1983);
Indiana Department of Revenue Sales Tax Bulletin #46 (July 11, 1983).

The taxpayer protests the assessment of use tax on the entire purchase price of photographs.

XIV. Use Tax – Liability for use tax on purchases of computer software.

Authority: Indiana Department of Revenue Sales Tax Bulletin #8 (Feb. 9, 1990).

The taxpayer protests the assessment of use tax on its purchases of computer software.

STATEMENT OF FACTS

The taxpayer is an Indiana company engaged in the business of manufacturing, and selling at wholesale, dried flowers for floral arrangements and decorations. The taxpayer receives shipments of flowers from the United States and other countries. The flowers are dried, bleached, painted, weighed, and packaged. The flowers are then either stored at the taxpayer's Indiana facility, shipped to its warehouses in Texas or Washington, or shipped directly to its customers. The taxpayer also manufactures display racks which are sold in retail transactions. A sales and use tax audit was completed on May 12, 1997, covering the years 1994 through 1996.

I. Use Tax - Calculation of use tax liability.

DISCUSSION

The taxpayer calculated use tax to be remitted during the audit period by taking a percentage of certain, non-production-related, ledger accounts. The percentage used by the taxpayer was based on the percentage used in a sampling projection done by a Department of Revenue auditor during a prior audit of the taxpayer for the period 1991-1993. In the current audit, the auditor examined all invoices for the audit period. The taxpayer maintains that the auditor did not give proper credit for taxes paid on purchases previously reported by the taxpayer. The taxpayer argues that this resulted in making the use tax liability greater than what the taxpayer calculated it should have been.

“An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.” Ind. Code § 6-2.5-3-2(a).

The auditor examined 100% of the taxpayer's invoices for the audit period. The taxpayer was allowed credit for all sales tax paid, but the taxpayer was not given proper credit for previously reported use tax paid.

FINDING

The taxpayer's protest is sustained.

II. Use Tax – Liability for use tax on purchases of pest control and fumigation supplies.

DISCUSSION

The taxpayer purchased insecticides and bird repellant to protect the horticultural products it receives and processes. The taxpayer was assessed use tax on these

purchases. The taxpayer maintains that spraying/fumigating the horticultural products is the first step in the production process and, therefore, its purchases of insecticides and bird repellent are exempt from use tax.

The taxpayer cites Ind. Code § 6-2.5-5-3(b): “Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.”

To qualify for the exemption, manufacturing machinery, tools, and equipment must have “an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.” Ind. Admin. Code tit. 45, r. 2.2-5-8(c).

The taxpayer maintains that the insecticide and bird repellent are directly used in the direct production of tangible personal property, that is, the dried flowers it sells for use as floral arrangements and decorations.

When the taxpayer directly applies insecticides and bird repellent to its products, the applicable statute is Ind. Code § 6-2.5-5-1(b):

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person’s business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

By spraying the insecticides and bird repellent directly onto the products the taxpayer manufactures, the insecticides and bird repellent are consumed in the direct production of the products and, thus, are exempt.

Any insecticides or bird repellent used to control pests in the area where the products are manufactured, and not directly applied to the products, are not exempt. Ind. Code § 6-2.5-5-1 does not apply because the insecticides and bird repellent are not consumed in the direct production of the products. In addressing the taxpayer’s argument that the manufacturing exemption of Ind. Code § 6-2.5-5-3 is the applicable statute, the RCA case is instructive. In the RCA case, the court found that air conditioning equipment was not tax exempt even though it was deemed to be essential for the economical manufacture of television picture tubes. Indiana Department of State Revenue v. RCA Corporation, 310 N.E.2d 96, 98 (Ind. App. 1974). The RCA court found that the air conditioning equipment was not directly used in the direct production of tangible personal property; that its immediate effect was not on the product itself but on the surroundings in which the manufacturing process took place. Id. at 100. In the instant case, insecticides and bird repellent not directly applied to the products have an immediate effect only on the

surroundings in which the taxpayer manufactures its products, not on the products themselves. Insecticides and bird repellent not directly applied to the products are not directly used in the direct manufacture of the taxpayer's products and are not exempt.

FINDING

The taxpayer's protest is partially sustained and partially denied.

III. Use Tax – Liability for use tax on purchases of forklift repair parts and fuel.

DISCUSSION

The taxpayer was assessed use tax on purchases of forklift repair parts and fuel. The taxpayer claims these purchases are partially tax exempt because the forklifts were used one third of the time in moving work in process between various stages of production. The auditor found the forklifts were used exclusively in pre-production and post-production activities. Thus, the entire cost of repair parts and fuel was subject to use tax. Other than stating in its protest letter that the forklifts were used one third of the time in production-related activities, the taxpayer has not provided any evidence showing exactly how the forklifts were used in a tax exempt manner.

"The notice of proposed assessment is *prima facie* evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Ind. Code § 6-8.1-5-1(b). The taxpayer's statement alone that the forklifts were used one third of the time in a tax exempt manner does not satisfy its burden of proof.

FINDING

The taxpayer's protest is denied.

IV. Use Tax – Liability for use tax on purchases of safety gloves, aprons, and boots.

DISCUSSION

The taxpayer was assessed use tax on its purchases of safety gloves, aprons, and boots. The taxpayer argues its purchases of safety gloves, aprons, and boots are tax exempt because they are necessary to protect its employees from extreme temperatures and potentially dangerous chemicals. "Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production" constitute essential and integral parts of the integrated production process and are tax exempt. Ind. Admin. Code tit. 45, r. 2.2-5-8(c)(2)(F).

The auditor determined that the safety gloves, aprons, and boots were used for the comfort of the employees and to keep their hands and clothes clean. The auditor found that most employees did not wear these items all the time and that whether these items were worn or not appeared to have no effect on the product or the employees' safety. The taxpayer has provided no evidence to support its claim that the items purchased were required to allow its employees to participate in the production process without sustaining injury or to prevent contamination of the product. The Department finds that the safety gloves, aprons, and boots were not required to allow the taxpayer's employees to participate in the production process without sustaining injury. Therefore, the taxpayer was properly assessed use tax for the purchase of these items.

FINDING

The taxpayer's protest is denied.

V. Use Tax – Liability for use tax on purchases of terry cloth gloves.

DISCUSSION

The taxpayer was assessed use tax on its purchases of terry cloth gloves. The taxpayer argues that these gloves are used as a means of applying paint to the outer edges of decorative pine cones. The taxpayer states that the employees wear the terry cloth gloves, dip their hands into paint, and paint the outer edges of the pine cones by rolling the pine cones in their gloved hands.

Transactions involving tools and equipment to be directly used in the direct production, manufacture, finishing, etc. of other tangible personal property are tax exempt. Ind. Code § 6-2.5-5-3(b). Terry cloth gloves used in the manner described by the taxpayer are tax exempt. Any terry cloth gloves which are used merely for the comfort of the employees, however, are not exempt and would be assessed use tax just as the items described in Part IV of this Letter of Findings.

FINDING

The taxpayer's protest is sustained.

VI. Use Tax – Liability for use tax on purchases of boiler compound and water softener salt.

DISCUSSION

The taxpayer was assessed use tax on purchases of boiler compound and water softener salt. The boiler compound is an additive put in the boiler water to help prevent scale build-up. A water softener is attached to the boiler and acts to help prevent scale build-

up and reduces the amount of boiler compound needed. The water softener salt is used in the water softener and is necessary for the water softener to operate properly.

The taxpayer argues that the boiler is a piece of manufacturing equipment and, therefore, the boiler compound and the water softener salt are tax exempt purchases. In support of its position, the taxpayer cites an Indiana Administrative Code example which states that “[c]hemicals used to treat water used in the production of whiskey to ensure that the water is pure or to prevent scale buildup in the boilers and pipes” are “essential and integral parts of the integrated production process and are, therefore, exempt.” Ind. Admin. Code tit. 45, r. 2.2-5-10(c)(2)(B).

The water treated by the chemicals in the cited example becomes part of the end product, the whiskey being produced. In the instant case, the water being treated with boiler compound and water softener salt does not become part of the end product. The boiler compound and the salt are only incidentally consumed by the taxpayer in its operation.

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person’s business of manufacturing [or] processing

Ind. Code § 6-2.5-5-5.1(b).

The boiler compound and salt are not directly consumed in the direct production of personal property as required by the statute. Instead, those items serve a maintenance function by helping to keep the boiler and pipes free of scale. The taxpayer’s products could be produced without the use of the boiler compound and the water softener salt. The production may be less efficient without use of those items, but production could continue. The boiler compound and water softener salt are not “essential and integral parts of an integrated process which produces tangible personal property.” Ind. Admin. Code tit. 45, r. 2.2-5-12(c). Since those items serve a maintenance function, they are not tax exempt items. Ind. Admin. Code tit. 45, r. 2.2-5-12(f).

FINDING

The taxpayer’s protest is denied.

VII. Use Tax – Liability for use tax on purchases of UPC and product labels.

DISCUSSION

The taxpayer was assessed use tax on purchases of various labels. The audit report described the labels as shipping labels. The taxpayer claims that the labels are actually UPC and product labels. According to the taxpayer, the labels are attached directly to the products it manufactures, making the labels part of the products and, therefore, exempt.

“Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business.” Ind. Code § 6-2.5-5-6. The taxpayer attaches (incorporates) the product labels to other tangible personal property which the taxpayer manufactures. Therefore, to the extent they are used to identify the product for the consumer, the product labels become part of the taxpayer’s product and are thus exempt purchases under Ind. Code § 6-2.5-5-6.

The UPC labels, however, may be used in a variety of ways. The taxpayer has failed to provide information regarding the utility of its UPC labels. Consequently, the Department must deny the taxpayer’s protest of these proposed assessments.

FINDING

The taxpayer’s protest is partially sustained and partially denied.

VIII. Use Tax – Liability for use tax on purchases of fan motors and fan repair parts.

DISCUSSION

The taxpayer was assessed use tax on purchases of fan motors and fan repair parts. The taxpayer argues the fans are used to dry the product during the production process. Machinery, tools, and equipment directly used in the direct production of tangible personal property are tax exempt. Ind. Code § 6-2.5-5-3(b). Replacement parts for exempt machinery, tools, and equipment are also exempt. Ind. Admin. Code tit. 45, r. 2.2-5-8(h)(2).

The auditor reports that the fans are used exclusively to move air in the production facility for the comfort of the employees. This is not a function related to production and, thus, the fans are not exempt equipment. The taxpayer does not offer any evidence to support its claim that the fans are exempt as equipment directly used in the direct production of personal property. The purchases of the fan motors and fan repair parts, therefore, are not tax exempt purchases.

FINDING

The taxpayer’s protest is denied.

IX. Use Tax – Liability for use tax on purchases of mothballs.

The taxpayer was assessed use tax on its purchases of mothballs. The taxpayer argues that the mothballs are put inside the product packaging to protect it from insects and other

vermin. The taxpayer concludes that the mothballs are part of packaging and, therefore, tax exempt. The taxpayer states that the courts have ruled that items used to prevent damage inside of containers are part of packaging and are exempt. The taxpayer does not, however, cite any cases to support this argument.

“The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added” Ind. Admin. Code tit. 45, r. 2.2-5-16(a). The mothballs the taxpayer adds to the boxes to prevent infestation by insects may act to help preserve the product during shipping, but mothballs are not packaging. They do not act to enclose or contain the products the taxpayer is shipping. The taxpayer’s purchases of mothballs are not tax exempt as containers or as wrapping material.

FINDING

The taxpayer’s protest is denied.

X. Use Tax – Liability for use tax on purchases of miscellaneous production supplies and equipment.

The taxpayer was assessed use tax on purchases of storage drums, drum stands, drum handles, thermometers, buckets, scoops, PVC tank fittings, and staples. The taxpayer protests these assessments, arguing that all of these items are exempt under Ind. Admin. Code tit. 45, r. 2.2-5-10, as machinery, tools, and equipment directly used in the processing or refining of tangible personal property.

A. Storage drums, drum stands, and drum handles.

The taxpayer states that the drums are used to temporarily store chemicals used in the production process. The chemicals are raw materials. “Tangible personal property used in or for the purpose of storing raw material . . . is subject to tax” Ind. Admin. Code tit. 45, r. 2.2-5-10(e). Thus, the storage drums and the associated equipment, the drum stands and handles, are subject to tax.

B. Thermometers.

The taxpayer states the thermometers it purchased “are used to test the temperature of various chemical processes during the production cycle.” Taxpayer’s Protest Letter, page 5 (received Oct. 29, 1997). The taxpayer maintains that the thermometers are items which are integral and essential to the production process making them exempt from use tax.

“Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing,

refining, or finishing of other tangible personal property.” Ind. Code § 6-2.5-5-3(b). To qualify for the exemption, manufacturing machinery, tools, and equipment must have “an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.” Ind. Admin. Code tit. 45, r. 2.2-5-8(c).

The thermometers monitor the temperature of the chemicals used to process the taxpayer’s products. They qualify as pieces of equipment that are essential and integral parts of an integrated process which produces tangible personal property and are, therefore, exempt from use tax.

C. Buckets and scoops.

The taxpayer states the buckets and scoops purchased are exempt from tax as equipment that is integral and essential to the production process. The buckets and scoops are used to scoop liquid raw materials from storage drums and introduce the materials into the production process.

(c) Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property.

...

(g) The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not, of itself, mean that the property “acts upon and has an immediate effect on the tangible personal property being processed or refined.” Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

Ind. Admin. Code tit. 45, r. 2.2-5-10.

The buckets and scoops purchased by the taxpayer do not act upon or have an immediate effect on the property being processed. The buckets and scoops may be practical necessities for the taxpayer to be able to process its products, but they are not an integral part of an integrated process which produces tangible personal property. The buckets and scoops are not exempt equipment.

D. PVC tank fittings.

The taxpayer states its purchases of PVC tank fittings are exempt as repair parts for exempt equipment, that is, the boiler equipment. "Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax." Ind. Admin. Code tit. 45, r. 2.2-5-8(2).

To determine if the PVC tank fittings are exempt, it must first be determined whether the boiler itself is exempt. In the taxpayer's production operation, the boiler is used to heat water to make steam. The steam heat raises and maintains the temperature of the chemicals used in the bleaching process. The steam also heats a room to a temperature of between 100 and 150 degrees where the taxpayer's products are dried. The boiler is equipment acquired for the direct use in direct production of tangible personal property. Ind. Code § 6-2.5-5-3(b). The boiler is exempt equipment and the PVC tank fittings, as replacement parts for the boiler equipment, are also exempt.

E. Staples.

The taxpayer states the staples it purchased are exempt. The "staples are used to attach the header card to the plastic bag containing the product." Taxpayer's Protest Letter, page 5 (received Oct. 29, 1997). "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail sales tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." Ind. Code § 6-2.5-5-3(b). The staples are property acquired by the taxpayer for direct use in the manufacture of the taxpayer's products and, as such, are not subject to tax.

FINDING

The taxpayer's protest is denied on items A., and C. The taxpayer's protest is sustained on items B., D., and E.

XI. Use Tax – Calculation of exempt portion of taxpayer's purchase of warehouse cart.

The taxpayer notes that the auditor had determined that 50% of the purchase price of warehouse carts were tax exempt. The taxpayer maintains the amount reported as subject to use tax for one of the cart purchases was miscalculated. The auditor is in agreement with the taxpayer on this issue. The amount subject to use tax should have been \$54.00, not the \$535.00 listed in the audit report. The taxpayer has met its burden of proving that the assessment was wrong. Ind. Code § 6-8.1-5-1(b).

FINDING

The taxpayer's protest is sustained.

XII. Use Tax – Liability for use tax on purchases of materials used in construction of bleach facility buildings.

DISCUSSION

In 1994, two buildings, which comprised the taxpayer's bleach facility, were destroyed by fire. The taxpayer rebuilt the two structures. The two buildings are the bleach unit and the greenhouse unit. The bleach unit is where the taxpayer bleached and rinsed its products. The products were then transferred to the greenhouse unit where they would be dried.

The taxpayer maintains that the materials purchased to rebuild the bleach facility units are tax exempt because the units are integral and essential to the processing of the taxpayer's products. The taxpayer cites an example from a Department of Revenue Sales Tax Bulletin in support of its argument. In the example, the materials used to construct a grain silo were exempt because the silo was integral and essential to the processing of the grain. Indiana Dept. of Revenue Sales Tax Bulletin #9(I)(B)(example 3)(April 1992).

The general rule for the application of sales or use tax is that a purchase of tangible personal property to be used in Indiana is subject to tax unless a specific exemption is available.

Indiana law provides several exemptions from sales and use tax relating to agricultural production. The exemptions are limited to purchases to be directly used in the direct production of food or commodities that are sold either for human consumption or for further food or commodity production.

Indiana Dept. of Revenue Sales Tax Bulletin #9(I)(April 1992).

Sales Tax Bulletin #9 does not apply to materials purchased by the taxpayer for construction of bleach facility buildings. "In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property." Ind. Admin. Code tit. 45, r. 2.2-4-21(a). The construction materials purchased by the taxpayer were properly assessed use tax by the auditor.

FINDING

The taxpayer's protest is denied.

XIII. Use Tax – Liability for use tax on purchases of photographs and photographic services.

DISCUSSION

The taxpayer was assessed use tax on purchases of photographs and photographic services. The taxpayer hired a photography studio to take photos for the taxpayer's advertising catalog in 1994. The taxpayer has submitted eight invoices for the photographic services performed during 1994. The invoices show services and transfers of tangible personal property stated separately. The taxpayer argues that the entire amount charged by the photography studio should be tax exempt. The taxpayer, citing Indiana Department of Revenue Sales Tax Information Bulletin #46 (July 11, 1983), maintains that: 1.) the price for the tangible personal property the taxpayer received and the price of the services were separately stated on the invoices, 2.) the cost of the tangible personal property was inconsequential, 3.) the photography studio primarily sells services, 4.) the personal property was used or consumed as a necessary incident to the service, and 5.) the photography studio paid sales or use tax on the property at the time it acquired it.

Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge, and;
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Ind. Admin. Code tit. 45, r. 2.2-4-2(a).

Transactions meeting the four requirements of Ind. Admin. Code tit. 45, r. 2.2-4-2(a) do not constitute selling at retail and, thus, are not subject to the gross retail tax. The transactions between the taxpayer and the photography studio do not, however, meet the requirements of the regulation cited. "Photographers when taking, developing and printing photographs which are ultimately sold to a customer are considered to be selling at retail with respect to the charges made for such photographs." Indiana Department of Revenue Sales Tax Information Bulletin #34, I (April 4, 1983). The photography studio

is a retail merchant selling at retail when selling photographs to the taxpayer. Thus, the first requirement of the regulation that the serviceman primarily be in an occupation which furnishes and sells services is not met. The object of the transaction in this case is the transfer of tangible personal property, not the provision of services.

The transfers of tangible personal property to the taxpayer are indicated on the invoices by the charges for prints. "An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." Ind. Code § 6-2.5-3-2(a). All of the charges for prints are subject to use tax. The separately stated charges for services, such as labor and processing, as well as the charges for materials used, such as film, are exempt.

FINDING

The taxpayer's protest is partially sustained and partially denied.

XIV. Use Tax – Liability for use tax on purchases of computer software.

DISCUSSION

The taxpayer was assessed use tax on its purchases of computer software in 1994 and in 1996. Computer hardware was purchased along with the software and was stated separately on the invoices. Sales tax was paid on the computer hardware purchases. The taxpayer argues that both software purchases were for customized software and, according to Indiana Dept. of Revenue Sales Tax Information Bulletin #8, are tax exempt.

Sales Tax Information Bulletin #8 states in part:

As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser. Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.

Indiana Dept. of Revenue Sales Tax Information Bulletin #8(II)(B) (Feb. 9, 1990).

The auditor determined that the computer software purchased by the taxpayer was canned software and subject to tax. The copies of invoices provided by the taxpayer do not indicate that the software was customized and the taxpayer has submitted no other evidence in support of its claim. Use tax was properly assessed on the purchases of computer software.

FINDING

The taxpayer's protest is denied.